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7
 8 BEFORE THE DEPARTMENT OF CORPORATIONS
 9 OF THE STATE OF CALIFORNIA

10
 11 In the Matter of) FILE NO. 7397
)
 12 THE CALIFORNIA CORPORATIONS) STATEMENT IN SUPPORT OF ORDER TO
) DISCONTINUE VIOLATIONS PURSUANT
 13 COMMISSIONER,) TO CORPORATIONS CODE SECTION 25249
) AND COMMISSIONER'S INTENTION TO
 14 Complainant,) MAKE ORDER FINAL
)
 15 v.) (CORPORATIONS CODE SECTION 25251)
)
 16 STOCK ADVISORS, INC.,)
)
 17 Respondent.)
)

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 19 Wayne Strumpfer, the Acting California Corporations Commissioner ("Commissioner") of
 20 the Department of Corporations ("Department") alleges and charges as follows:

21 1. Stock Advisors, Inc. holds a valid and unrevoked investment adviser certificate issued
 22 by the Commissioner on August 26, 1999 pursuant to Corporations Code section 25230. Stock
 23 Advisors, Inc. is an investment adviser business located at 19252 Vista Grande Way, Northridge, CA
 24 91326. Stock Advisors, Inc. is a California corporation. Robert E. Welch ("Welch") is Stock
 25 Advisors, Inc.'s president.

26 2. On or about February 22, 2005, the Commissioner commenced a regulatory
 27 examination of Stock Advisors, Inc. The examination revealed violations of regulations
 28

1 promulgated pursuant to the Corporate Securities Law of 1968 (“CSL”), found at Corporations Code
2 section 25000 et seq.

3 3. One of these violations consisted of Stock Advisors, Inc.’s failure to file annual
4 financial reports with the Commissioner within 60 or 90 days, as applicable, of the end of Stock
5 Advisors, Inc.’s fiscal year (Cal. Code Regs., tit. 10, § 260.241.2, subdivision (a)(2)). Stock
6 Advisor’s fiscal year ends on June 30. The annual report filing requirement provides the Department
7 with a regulatory mechanism to validate a firm’s liquidity and financial integrity on a yearly basis to
8 ensure that licensees maintain the necessary net capital for the protection of the public. Stock
9 Advisors, Inc.’s failure to meet its reporting requirements prevented the Department from
10 determining, as part of its regulatory exam, if Stock Advisors, Inc. met the capital requirements
11 imposed by the CSL and the regulations enacted thereunder.

12 4. Corporations Code section 25241 provides that investment advisers are required to
13 maintain books and records that are subject to examination by, and to file such reports as required
14 by, the Commissioner. Corporations Code section 25241 provides, in pertinent part, as follows:

15 [E]very investment adviser licensed under Section 25230 shall make and keep
16 accounts, correspondence, memorandums, papers, books, and other records and shall file
17 financial and other reports as the commissioner by rule requires

18 5. California Code of Regulations, title 10, section 260.241.2 (“section 260.241.2”),
19 subdivision (a), requires the filing of an annual financial report by certain investment advisers. Prior
20 to April 3, 2003¹, subdivision (a)(5) of section 260.241.2 required the annual financial reports to be
21 submitted within 60 days of the investment adviser’s fiscal year-end. The pre-April 3, 2003 version
22 of subdivision (a)(2) of section 260.241.2, provided as follows:

23 (a) General Rule. Subject to the provisions of subsection (c) of this section, ... every
24 licensed investment adviser subject to the provisions of Section 260.237.1 of these rules,
25 shall file an annual financial report containing the information required by a form or forms to
26 be supplied or approved by the Commissioner, as follows:
27 ...

28 ¹ Various provisions of the regulations were amended and became effective April 3, 2003. This action seeks
administrative penalties based on violations that occurred under statutes and rules both prior to and after the effective
date of the amendments. The post-April 3, 2003 version of pertinent regulations are included infra.

(2) The annual report for investment advisers shall contain a Statement of Financial Condition. Supporting schedules shall contain computations of net capitals, aggregate indebtedness and ratios required under Section 260.237.1 and the certificate of the accountant required under subsection (e) of Section 260.237 of these rules.

6. Prior to April 3, 2003, California Code of Regulations, title 10, section 260.237.1 (“section 260.237.1”) contained the capital requirements for investment advisers. Subdivision (a)(2) of section 260.237.1 provided, in pertinent part, as follows:

(a) No investment adviser who has any power of attorney from any investment advisory client to execute transactions . . . shall permit its total aggregate indebtedness to exceed 500% of its tangible net capital or permit its current aggregate indebtedness to exceed its current net capital; and,

...

(2) If the investment adviser has any power of attorney from any investment advisory client to execute transactions and does not have regular or periodic custody or possession of any of its investment advisory clients’ securities or funds, except the receipt of prepaid subscriptions for periodic publications, or other investment advisory services, it shall at all times have and maintain tangible net capital of not less than \$5,000

Subdivision (c) of section 260.237.1 provided that for purposes of section 260.237.1, subdivision (a), all financial information shall be determined in accordance with generally accepted accounting principles.

7. The Department's examiner found during the regulatory exam on February 22, 2005, that Stock Advisors, Inc. had power of attorney and discretionary power to execute transactions in the brokerage accounts of its investment adviser clients. Therefore, prior to April 3, 2003, Stock Advisors, Inc. was required to meet the capital requirements provided for under section 260.237.1, subdivision (a)(2), and to show proof of compliance with this regulation by filing annual financial reports, as required by section 260.241.2, subdivision (a).

8. The post-April 3, 2003 version of section 260.241.2, subdivision (a)(5), requires the filing of an annual financial report by certain investment advisers within 90 days of their fiscal year-end. Further, the post-April 3, 2003 version of subdivision (a)(2) of section 260.241.2 provides as follows:

(a) General Rule. Subject to the provisions of subsection (c) of this section, ... every licensed investment adviser subject to the provisions of Section 260.237.1 or Section 260.237.2, as applicable, of these rules, shall file an annual financial report containing the

1 information required by a form or forms to be supplied or approved by the Commissioner, as
2 follows:

...

3 (2) This annual report for investment advisers shall contain a Statement of Financial
4 Condition. Supporting schedules shall contain computations of net capitals, aggregate
5 indebtedness and ratios required under Section 260.237.1 or minimum financial requirements
6 required under Section 260.237.2, as applicable, and the certificate of the accountant required
7 under subsection (e) of Section 260.237 of these rules.

8 9. After April 3, 2003, an investment adviser licensed prior to April 01, 2003 may
9 comply with either the minimum financial requirements in section 260.237.1 or those found in
10 California Code of Regulations, title 10, section 260.237.2 ("section 260.237.2") until January 1,
11 2005, at which time section 260.237.1 shall become inoperative and an investment adviser shall
12 comply with the minimum financial requirements of section 260.237.2 (Cal. Code Regs., tit. 10, §
13 260.237.1). In pertinent part, subdivision (a)(2) of the post-April 3, 2003 version of section
14 260.237.1 is identical to the pre-April 3, 2003 version of that section.

15 The post-April 3, 2003 version of subdivision (a) of section 260.237.2 provides, in pertinent
16 part, as follows:

...

17 (a) Every investment adviser who has custody of client funds or securities shall maintain at
18 all times a minimum net worth of \$35,000, and every investment adviser who has
19 discretionary authority over client funds or securities but does not have custody of client
20 funds or securities, shall maintain at all times a minimum net worth of \$10,000.

21 10. As stated above, the Department's examiner found during the regulatory exam on
22 February 22, 2005, that Stock Advisors, Inc. had power of attorney and discretionary power to
23 execute transactions in the brokerage accounts of its investment adviser clients. Therefore, after
24 April 3, 2003, Stock Advisors, Inc. was required to meet either the minimum financial requirements
25 provided in either section 260.237.1, subdivision (a)(2), or section 260.237.2, subdivision (a), and to
26 show proof of compliance with one of the two regulation sections by filing annual financial reports,
27 as required by section 260.241.2, subdivision (a). At the time of the February 22, 2005 examination,
28 Stock Advisors, Inc. had failed to submit its annual financial reports for the fiscal years ending in
2002, 2003, and 2004, in violation of California Code of Regulations, title 10, section 260.241.2,
subdivision (a). As a result of Stock Advisors, Inc.'s violation of section 260.241.2, subdivision (a),

1 the Department was unable to determine, at the end of Stock Advisors, Inc.'s fiscal year, if the firm
2 was in compliance with the net capital requirements of section 260.237.1 and/or section 260.237.2.

3 11. A prior regulatory examination of Stock Advisors, Inc. on November 15, 2001, also
4 revealed, in part, the failure to file an annual financial report for the year 2001. In correspondence
5 with the Department at that time, Mr. Welch assured the Department that Stock Advisors, Inc. would
6 not repeat the annual financial report filing violation in the future.

7 12. Corporations Code section 25249 authorizes the Commissioner to issue an order
8 directing any investment adviser to discontinue any violation of any provision of the Corporate
9 Securities Law and any rules promulgated thereunder. Specifically, Corporations Code section
10 25249 provides, in pertinent part:

11 If, after examination or investigation, the commissioner has reasonable grounds to believe
12 that any ... investment adviser has violated any law or rule binding upon it, the commissioner
13 shall, by written order addressed to the ... investment adviser, direct the discontinuance of
14 the violation. The order shall be effective immediately, but shall not become final except in
15 accordance with the provisions of Section 25251.

16 13. Corporations Code section 25251 provides as follows:

17 (a) No order issued pursuant to Section 25249 or 25250 may become final except after
18 notice to the affected ... investment adviser of the commissioner's intention to make the
19 order final and of the reasons for the finding. The commissioner shall also notify the ...
20 investment adviser that upon receiving a request the matter shall be set for hearing to
21 commence within 15 business days after receipt of the request. The ... investment adviser
22 may consent to have the hearing commence at a later date. If no hearing is requested within
23 30 days after the mailing or service of the required notice, and none is ordered by the
24 commissioner, the order may become final without a hearing and the ... investment adviser
25 shall immediately discontinue the practices named in the order. If a hearing is requested or
26 ordered, it shall be held in accordance with the provisions of the Administrative Procedure
27 Act (Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the
28 Government Code), and the commissioner shall have all of the powers granted under that act.
If, upon the conclusion of the hearing, it appears to the commissioner that the ... investment
adviser is conducting business in an unsafe and injurious manner or is violating any law of
this state, or any rule binding upon it, the commissioner shall make the order of
discontinuance final and the ... investment adviser shall immediately discontinue the
practices named in the order.

(b) The ... investment adviser may within 10 days after an order is made final commence an
action to restrain enforcement of that order. If the enforcement of that order is not enjoined
within 10 days by the court in which the action is brought, the ... investment adviser shall
comply with the order.

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2 14. By reason of the foregoing, Stock Advisors, Inc. has willfully violated California
3 Code of Regulations, title 10, section 260.241.2, subdivision (a), justifying the issuance of an Order
4 to Discontinue Violations. Stock Advisors, Inc., as a licensee, was obligated to have knowledge of,
5 and to comply with, the provisions of the Corporate Securities Law and the regulations thereunder to
6 maintain its investment adviser certificate. Furthermore, the Department had given Stock Advisors,
7 Inc. prior notice of the requirements of California Code of Regulations, title 10, section 260.241.2,
8 subdivision (a). Stock Advisors, Inc. has continued to violate this regulation, despite the
9 Department's actual notification and Mr. Welch's assurances of future compliance.

10 15. Therefore, pursuant to Corporations Code section 25249, the Commissioner has
11 issued an order directing Stock Advisors, Inc. to discontinue violating California Code of
12 Regulations, title 10, section 260.241.2, subdivision (a).

13 WHEREFORE, good cause showing, and pursuant to Corporations Code section 25251, the
14 California Corporations Commissioner hereby notifies Stock Advisors, Inc. of his intention to make
15 final the Order to Discontinue Violations Pursuant to Corporations Code Section 25249.

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17 Dated: March 27, 2006

WAYNE STRUMPFER
Acting California Corporations Commissioner

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19
20 By: _____
21 ALEXANDER M. CALERO
22 Corporations Counsel
23 Enforcement Division
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